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CHAIRMAN, PRESIDENT &  
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October 31, 2011

**VIA FEDEX and EMAIL ([regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov))**

Ms. Jennifer J. Johnson  
Secretary of the Board  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Re: Interim Final Rule Relating to Savings and Loan Holding Companies  
Docket No. R-1429; RIN No. 7100 AD 80

Dear Ms. Johnson:

NorthEast Community Bancorp MHC, NorthEast Community Bancorp, Inc. and NorthEast Community Bank (collectively, "NorthEast") hereby submit comments on the Interim Final Rule issued by the Board of Governors of the Federal Reserve System ("FRB") on August 11, 2011. Our comments are primarily focused on the provisions of Regulation MM set forth at 12 C.F.R. Section 239.8(d), which addresses dividend waivers by grandfathered mutual holding companies.

As discussed in further detail below, NorthEast believes that the requirement of Regulation MM that grandfathered mutual holding companies ("Grandfathered MHCs") receive member approval of dividend waivers is inconsistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), contrary to well-established principles of corporate law and unduly burdensome on mutual holding companies ("MHCs"). For these reasons, we request that the FRB eliminate the requirement for a member vote and approval of dividend waivers by Grandfathered MHCs.

## **I. Background**

*In July 2006, NorthEast Community Bank (the "Bank") reorganized into the mutual holding company form of organization and in connection therewith conducted a minority stock offering of the common stock of NorthEast Community Bancorp, Inc., a mid-tier stock holding company formed in connection with the MHC reorganization (the "Company"). The Bank made the decision to reorganize into the mutual holding company structure rather than the full stock holding company structure as it enabled the resulting entity to raise capital as needed.*

As of June 30, 2011, the Bank had total assets of \$432.4 million, total liabilities of \$345.1 million and total equity capital of \$87.3 million. At that same date, the Company had total assets of \$444.2 million, total liabilities of \$336.7 million and total stockholder's equity of \$107.5 million. Both entities are well-capitalized and the Bank has had an outstanding rating under the Community Reinvestment Act for the past 15 years.

The Company has declared and paid dividends to its minority stockholders since 2007. Northeast Community Bancorp, MHC ("NorthEast MHC"), the Company's majority stockholder, has waived receipt of all dividends declared by the Company since the Company began paying dividends. On a cumulative basis, NorthEast MHC has waived \$3,491,400 of dividends from the Company through June 30, 2011.

NorthEast MHC is a grandfathered mutual holding company under the provisions of the Dodd-Frank Act and the Interim Final Rule.

## **II. Comments on Specific Provisions of Regulation MM**

### **A. Requiring an MHC's Members to Approve a Dividend Waiver is Not Required by the Dodd-Frank Act (Section 239.8(d))**

Section 239.8(d) of Regulation MM addresses dividend waivers by grandfathered mutual holding companies and requires a Grandfathered MHC to annually obtain the approval of the waiver of dividends by the mutual holding company by a vote of a majority of the MHC's members eligible to vote. As the FRB is aware, the Dodd-Frank Act specifically provides that the FRB may not object to a dividend waiver by a Grandfathered MHC if: (i) the waiver would not be detrimental to the safe and sound operation of the savings association; and (ii) the board of directors of the Grandfathered MHC expressly determine that the dividend waiver is consistent with the fiduciary duties of the board of directors to the mutual members. The purpose of this provision was to preserve the historical treatment of dividend waivers by the OTS in recognition of the fact that the FRB had historically been opposed to and did not grant dividend waivers by MHCs formed by state savings banks. Nowhere in the Dodd-Frank Act is there a requirement that the members of an MHC approve the dividend waiver. Rather, the

Dodd-Frank Act requires the board of directors of a Grandfathered MHC to conclude that the waiver of dividends is consistent with the board's fiduciary duties to the members of the MHC and permits the FRB to determine the form and substance of the board resolution adopted by the board of directors of a Grandfathered MHC in reaching such conclusion. It should be noted that this statutory provision of the Dodd-Frank Act tracks verbatim the language in the mutual holding company regulations of the former OTS governing dividend waivers. In applying that former OTS regulation to dividend waiver requests by MHCs, the OTS never required a member vote prior to granting approval of a dividend waiver by an MHC. To require that members of the MHC approve the dividend waiver is a substantive additional requirement – unrelated to the “form and substance” of a board resolution – that the FRB is imposing on Grandfathered MHCs. If Congress believed that such a member vote should be required before a dividend waiver could be approved by the FRB, it would have included such a requirement in the legislation. We believe the imposition of such a requirement is inconsistent with the intent of the dividend waiver provisions in the Dodd-Frank Act and should not be included in the final rule.

B. The Board of Directors of the MHC Can Satisfy its Fiduciary Duties Under Corporate Law without a Member Vote

Section 625(a)(11)(C) of the Dodd-Frank Act requires that the board of directors of a Grandfathered MHC conclude, in connection with making a decision to waive dividends, that the proposed dividend waiver is consistent with the fiduciary duties of the board of directors to the mutual members of the MHC. The FRB notes in the preamble to the Interim Final Rule that it believes there is a conflict of interest that exists because directors of an MHC are also stockholders of the subsidiary stock holding company that is declaring dividends to its stockholders. The FRB suggests in the preamble to the Interim Final Rule, as well as in the regulatory language itself, that the directors should consider waiving their rights as individual stockholders to receive dividends in order to address this perceived conflict of interest.

It is common in the banking industry, particularly for community banks, that the board of directors of the financial institution and its holding company(s) are comprised of the same individuals. In connection with a minority stock offering by a stock subsidiary of an MHC (as well as in a mutual to stock conversion), it is expected by the investor community, as well as by the converting institution's depositors who decide to participate in the offering, that management of the financial institution will purchase common stock in the offering. Indeed, often times the amount of management purchases in the offering can make a difference as to the success of the offering. The establishment of an employee stock ownership plan, which benefits all employees of the financial institution (and does not benefit directors as they can not participate in such a plan unless they are also employees of the institution), is also standard in minority stock offering and mutual to stock conversion transactions. The provisions of Regulation MM that attempt to

resolve the perceived conflict of interest in board approvals of dividend waivers would unnecessarily change a process that has historically worked very well.

In making a decision to waive dividends, the FRB should defer to the board of directors of MHCs in the exercise of their fiduciary duties and respect the protections afforded such directors under the business judgment rule.

The concept of dual directorships is not peculiar to the banking industry and can be found in virtually any industry where there are parent and subsidiary corporations. The courts have recognized that directors in such a position may owe a fiduciary duty to each corporation. In Delaware, the applicable standard requires that "individuals who act in a dual capacity as directors of two corporations, one of whom is the parent and the other the subsidiary, owes the same duty of good management to both corporations, and in the absence of an independent negotiating structure, or the director's total abstention from any participation in the matter, this duty is to be exercised in light of what is best for both companies." (*Weinberger v. UOP, Inc.*, 457 A.2d 701, 710-711 (Del. 1983)).

We note that with respect to the perceived conflict of interest, Delaware law specifically provides that decisions by directors who have an interest in a transaction are protected from invalidation if such transaction is found to be fair to the corporation. See *Delaware General Corporation Law, Section 144* (8 Del.C. §144). We further note that it is a well-settled principle of corporate law that a director is considered to be "interested" in a matter if he or she will be materially affected, either to his benefit or his detriment, by a decision of the board of directors, in a manner not shared by the corporation and the stockholders.

In the case of NorthEast, and as is true for many MHCs, each director of NorthEast MHC is a member of NorthEast MHC and is a stockholder of the Company. As such, the determination by the Board of Directors of NorthEast MHC that the waiver of dividends by the MHC is in the best interests of the MHC and its members affects the individual MHC directors to the exact same degree as any other member of the MHC. There is no benefit or detriment to MHC members that is any different than any perceived benefit or detriment to directors of the MHC who are also members.

We note that there is no real detriment to an MHC member if an MHC waives its right to dividends, as members of an MHC have no legal rights to the assets or capital of an MHC except to the extent an MHC dissolves or liquidates. As such, the FRB's concern about the perceived detriment to MHC members is misplaced. The only actual way in which an MHC member could be disadvantaged by dividend waivers would be in a second-step conversion and the former OTS addressed this issue by determining that waived dividends would not, be considered when determining the exchange ratio for the public stock outstanding in connection with a second-step

conversion. For Grandfathered MHCs, the Dodd-Frank Act continued the OTS treatment of dividend waivers in second-step conversions and Regulation MM incorporates that treatment.

C. There is Significant Cost and Time Involved for an MHC to Obtain Member Approval of the Dividend Waiver on an Annual Basis

As the FRB may be aware, members of mutual associations and mutual holding companies are different than stockholders of a stock company. Members are depositors of the thrift institution and generally are not interested in the governance of the entity. Many do not understand the difference between a mutual and stock entity and rarely exercise their right to vote. Indeed, that is one of the reasons that "running" proxies are authorized and used for non-significant matters for which a member vote is required. For a mutual to stock conversion or a mutual holding company reorganization – both of which are significant transactions in the life of a mutual entity – the regulations of the former OTS required approval by a majority of the members entitled to vote and prohibited the use of running proxies. The FRB has retained this requirement in Regulation MM for MHCs. The decision as to whether a mutual holding company should waive dividends from its subsidiary holding company is a decision for the board of directors of the MHC to make. It is not a significant corporate decision that would or should require the vote of the members. As a general matter, the declaration of dividends and, more broadly, the distribution of capital are matters that are customarily left to the determination of corporate boards of directors. The proposed member vote would significantly depart from well established corporate law requirements.

Section 239.8(d)(2)(iv) of Regulation MM requires that the vote of members on the dividend waiver be obtained annually at a meeting of members and requires a proxy statement that contains certain specified information regarding the proposed dividend waiver. Since the Interim Final Rule prohibits the use of running proxies for obtaining the vote of members of the MHC on the dividend waiver, the MHC would need to retain counsel to assist in the preparation of the proxy statement and annual meeting documents and would have to retain a proxy solicitor to assist in obtaining the vote of a majority of members entitled to vote at such meeting. Management time would also have to be devoted to assisting in obtaining the vote. As discussed herein, depositor members do not typically vote and therefore significant effort is required to obtain a majority vote of the members when running proxies cannot be used. There would also be a cost to the MHC for printing and mailing the proxy materials and for mailing any follow up materials needed to obtain the necessary vote. This type of proxy solicitation is similar to what is required for major corporate transactions by MHCs, such as a second-step conversion or the initial reorganization of a mutual into the MHC form of organization. Based on discussions with a proxy solicitation firm and legal counsel, the cost to a Grandfathered MHC for obtaining such a vote would be approximately \$125,000. Given that the amount of dividends waived by the MHC on an annual basis average \$872,850, the cost of obtaining the member vote would represent

approximately 14.3% of the amount of waived dividends. This is an unnecessary expense given such a vote is not legally required under the Home Owners' Loan Act of 1933, as previously in force and as amended by the Dodd-Frank Act ("HOLA"), nor was such a vote required under prior regulations or practices of the OTS.

D. The Requirement of a Member Vote to Approve a Dividend Waiver is Inconsistent with HOLA and the Charter of the MHC

Under the HOLA, there is no statutory requirement that the members of an MHC have voting rights, other than in connection with certain specified transactions consistent with the statutory language governing mutual savings associations and the voting rights of members of such associations. The OTS and its predecessor, the Federal Home Loan Bank Board, adopted regulations and specified the form of charter for MHCs, based on the form applicable to mutual savings associations. The HOLA requires the approval of members for a mutual to stock conversion, and the regulations of the former OTS required member approval of certain other types of significant transactions. A review of the form of MHC Charter and MHC Bylaws, which the FRB has adopted as part of Regulation MM, makes clear that the ability of members to vote on corporate matters is very limited. Specifically, members have the right to vote for the election of directors, to amend the charter of the MHC, and amend the bylaws of an MHC (although such bylaws can be amended by the board of directors without approval by the members). Running proxies can be utilized to obtain each of these votes. Under former OTS regulations, current regulations of the Office of the Comptroller of the Currency with respect to mutuals and under Regulation MM with respect to MHCs, members of a federal mutual savings association or mutual holding company are not required to vote to approve a merger, although the former OTS retained the authority in its regulations to specifically require such in connection with its review of a merger application. The reason for such limited rights is that mutual members are much more like creditors of the mutual entity rather than like stockholders, as has been recognized by both the former OTS as well as the courts. Additionally, as discussed herein, members have very limited rights to the assets or profits of the mutual entity. As such, mutual members have historically taken little interest in the governance or operations of the mutual entity. By requiring the members of an MHC to annually approve dividend waivers by MHCs, the FRB is expanding the rights of mutual members in a manner that is inconsistent with the governance documents of mutual holding companies, case law and historical practices with respect to mutual entities.

E. Waiver of Dividends Allow for Retention of Capital at the Company and Avoid Adverse Tax Consequences

The waiver of dividends by an MHC avoids adverse income tax consequences and allows for the retention of funds at the stock holding company for investment while allowing the stock

holding company to serve as a source of strength for the subsidiary banking institution. If the FRB determines to retain the requirement that MHCs obtain member approval of MHC dividend waivers, such requirement could effectively result in the elimination of dividend waivers by Grandfathered MHCs due to the time and expense involved in obtaining such a vote or as a result of the inability to obtain such approval due to the difficulty in obtaining the required vote given member apathy.

In the event MHCs did not waive dividends, the stock subsidiaries of such entities could be forced to reduce dividend payments to the stockholders, which in turn could depress the market value of such MHCs. In this regard, it should be noted that the dividend payout ratio for publically traded MHCs is substantially lower than the dividend payout ratio for all publically traded thrifts, on average. Similarly, the dividend yield for publically traded MHCs and all publically traded thrifts was substantially similar at 2.16% and 1.87%, respectively, as of September 16, 2011. If public subsidiaries of MHCs are forced to reduce their dividends below the average for public thrifts, the market value of such entities may become depressed, potentially leading to safety and soundness concerns and increased pressure from stockholders.

Further, the adverse tax consequences resulting from dividends being paid to the MHC are costly to the consolidated entity. We believe both of these factors more readily give rise to safety and soundness concerns than does the waiver of dividends by an MHC.

Specifically, in the case of NorthEast, NorthEast MHC and the Company are not eligible to file a consolidated income tax return because NorthEast MHC does not own 80% or more of the issued and outstanding common stock of the Company. Thus, any dividends paid to NorthEast MHC by the Company will be treated as taxable income to NorthEast MHC. In effect, this will result in double taxation since the Company is paying dividends with after-tax income and NorthEast MHC would be required to pay tax on the dividends received from the Company. This is the case for most MHCs.

In addition, with a waiver of dividends, the amount of money that would have been paid to the MHC can remain at the Company and can be invested in securities or other investments without incurring additional tax liability or can be downstreamed to the Bank if needed. The funds that are waived by an MHC and retained by its subsidiary stock holding company increase the value of the stock holding company and benefit the MHC as the majority stockholder of the stock holding company without adverse tax consequences. As a result, the members of the MHC would benefit since any increase in the value of the Company's stock will benefit the MHC members in the unlikely event of any liquidation of the MHC.

F. Imposing a Member Vote Requirement Could Effectively Eliminate the Dividend Waiver for Grandfathered MHCs and the Grandfather Treatment of Such Dividends in Second-Step Conversions

Section 625(a)(11)(E)(ii) of the Dodd-Frank Act specifically grandfathers the position of the former OTS with respect to the impact of dividend waivers in connection with a second-step conversion by an MHC. This is discussed in more detail in Section II. B. above. As the requirement of a member vote to approve dividend waivers could effectively result in the elimination of dividend waivers by Grandfathered MHCs, the FRB will effectively be rendering Section 625(a)(11)(E)(ii) meaningless. This was clearly not the intent of the Dodd-Frank Act provisions, which specially addressed and preserved the OTS' treatment of dividend waivers in second-step conversions.

G. Non-Grandfathered MHC should be Permitted to Waive Dividends Utilizing Criteria Similar to That Applied to Grandfathered MHCs

The mutual holding company structure has been a very viable structure for mutual institutions that need or desire to raise capital as well as for those that desire to increase their competitiveness in the financial services marketplace. The enactment of the Dodd-Frank Act and the uncertainty surrounding the future of MHCs has adversely affected the market value of MHC stocks and has resulted in virtually no new MHCs with public stock holding company subsidiaries in the last two years. The adoption of the Interim Final Rule by the FRB and the discussions and regulatory language contained therein on dividend waivers, perceived conflicts of interest and stock repurchases by entities in the mutual form of organization has only added to the cloud hanging over mutual holding companies. The provisions of the Interim Final Rule make it virtually impossible for a non-grandfathered MHC to obtain FRB approval to waive dividends. We respectfully request that the FRB reconsider its position on non-grandfathered MHCs.

The reality is that the MHC structure enables mutual institutions to reorganize in a structure that allows them to raise capital as needed and thereby provides mutuals with a holding company that can serve as a source of strength to the entity if needed. Not every mutual desires to be a public company and, under the mutual to stock conversion regulations of the former OTS, as adopted by the OCC, the only way for a mutual to raise equity capital is to do so through a public offering. The MHC offers a great alternative for those mutual entities that cannot or do not want to become full public entities. Such a structure also allows mutual entities to reorganize into a structure that enables the resulting entity to be more competitive and attract and retain qualified executives and personnel in the same manner as stock companies through stock-based benefit plans. The provisions of the Interim Final Rule, coupled with the FRB's past policies on MHCs formed by state savings banks, will likely lead to the eventual elimination of the MHC as



a viable alternative to a full public company for mutuals, the effect of which is already being seen. We believe that it is beneficial to all parties involved – the savings associations and savings banks, their members and their communities as well as to the banking regulators, to preserve this structure as a viable alternative for mutual institutions. As such, we respectfully request that the FRB consider amending the Interim Final Rule in a manner that ensures the continued viability of this structure.

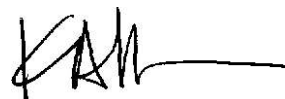
### **III. Conclusion**

In conclusion, we respectfully request that FRB amend the Interim Final Rule to remove the requirement that an MHC's members approve dividend waivers by Grandfathered MHCs. We also request the FRB to reconsider its position on the waiver of dividends by non-grandfathered MHCs to make it possible for such entities to waive dividends and thereby help ensure the continued viability of the mutual holding company form of organization.

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We appreciate the opportunity to comment on the Interim Final Rule. If you have any questions or would like us to elaborate further on any of the points discussed herein, please do not hesitate to contact the undersigned.

Very truly yours,



Kenneth A. Martinek  
Chairman, President and Chief Executive Officer  
NorthEast Community Bancorp, MHC  
NorthEast Community Bancorp, Inc.  
NorthEast Community Bank

cc: Board of Directors,  
NorthEast Community Bancorp, MHC